

URS-T-2
RECEIVED

MAY 22 5 39 PM '00

**BEFORE THE
POSTAL RATE COMMISSION**

POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

POSTAL RATE AND FEE CHANGES, 2000

DOCKET NO. R2000-1

**DIRECT TESTIMONY
OF
STEPHEN E. SELICK
ON BEHALF OF
UNITED PARCEL SERVICE
ON COST SEGMENT 3**

TABLE OF CONTENTS

	<u>Page</u>
INTRODUCTION	1
PURPOSE OF TESTIMONY AND SUMMARY OF CONCLUSIONS.....	2
MODS-BASED ALLOCATION OF MAIL PROCESSING COSTS	3
A. The Degen/Van-Ty-Smith MODS-Based Approach Addresses the Concerns Raised by the Commission in Docket No. R97-1	3
B. The Postal Service's Proposed Distribution Method Should Be Used, with Minor Modifications	4
CALCULATION OF IOCS OBSERVATIONS AND TALLY DOLLARS BY COST POOL	7
CALCULATION OF NON-BMC OUTGOING MAIL PROCESSING COSTS INCURRED BY DBMC-ENTRY PARCELS	7
SUMMARY OF CONCLUSIONS.....	7

INTRODUCTION

My name is Stephen E. Sellick. I am a Vice President at PHB Hagler Bailly, Inc. ("PHB"), an economic and management consulting firm with principal U.S. offices in Washington, D.C.; Cambridge, Massachusetts; Los Angeles and Palo Alto, California; and New York, New York. PHB was formed through the merger of Putnam, Hayes & Bartlett, Inc. and Hagler Bailly, Inc. in 1998. I am located in PHB's Washington, D.C. office.

I have more than ten years of consulting experience, including a wide range of assignments in regulatory economics, cost accounting, and financial analysis of regulated industries. In addition, I have extensive experience in environmental litigation.

I have worked on PHB's analytical investigations of United States Postal Service ("Postal Service") costing issues since 1990. In Docket No. R90-1 and again in Docket No. R94-1, I assisted Dr. George R. Hall in the preparation of analyses and testimony regarding the attributable costs of Parcel Post, Priority Mail, and Express Mail. In Docket No. R94-1, I assisted Dr. Colin C. Blaydon in the preparation of analyses and testimony concerning the treatment of mixed mail costs in the In-Office Cost System ("IOCS"). In Docket No. MC95-1, I assisted Ralph L. Luciani in the preparation of analyses and testimony regarding the costs associated with parcels handled by the Postal Service in First Class and Standard (A) Mail and in preparing supplemental testimony regarding rate design for Standard (A) Mail parcels. In Docket No. R97-1, I presented direct testimony regarding the Postal Service's proposal to modify the costing in Cost Segment 3 to incorporate a Management Operating Data System ("MODS")

1 based approach. I also presented supplemental and rebuttal testimony in Docket No.
2 R97-1 regarding the MODS-based approach for Cost Segment 3.

3 Since 1995, I have visited and observed the operations at a number of Postal
4 Service facilities, including the Washington, D.C., BMC on two different occasions; two
5 Sectional Center Facilities; two Associate Offices/Delivery Units; a HASP ("Hub and
6 Spoke Project") facility; and an Air Mail Center.

7 I hold a B.S. in Economics from the University of Pennsylvania's Wharton School
8 of Business and an M.A. in Public Policy Studies from the University of Chicago.

9 **PURPOSE OF TESTIMONY AND**
10 **SUMMARY OF CONCLUSIONS**

11 I have been asked to examine the Postal Service's new methods of costing in
12 Cost Segment 3. In so doing, I have reviewed the testimony and workpapers of Postal
13 Service witnesses Degen (USPS-T-26) and Van-Ty-Smith (USPS-T-17), among others.

14 My testimony provides the following:

- 15 1. A recalculation of base year Cost Segment 3 costs using (a) the improved
16 methods proposed by Postal Service witnesses Degen and Van-Ty-Smith
17 and (b) the Commission's approach using 100 percent mail processing
18 labor cost variability as proposed by UPS witness Neels (UPS-T-1);
- 19 2. An identification of the number of IOCS observations and tally dollar costs
20 by cost pool for use by UPS witness Neels in his testimony on mail
21 processing costs (UPS-T-1); and

1 3. An identification of the costs of certain Parcel Post operations which are
2 then used by UPS witness Ralph (UPS-T-5) to calculate a more
3 appropriate DBMC discount.

4 **MODS-BASED ALLOCATION**
5 **OF MAIL PROCESSING COSTS**

6 The Postal Service presents several modifications and improvements to its
7 MODS-based distribution of mail processing costs among the subclasses of mail.
8 These modifications and improvements are discussed and presented in the testimony of
9 Postal Service witnesses Degen and Van-Ty-Smith. Mr. Degen also discusses the
10 degree to which mail processing labor costs are variable and therefore attributable; my
11 testimony does not address this section of Mr. Degen's testimony. I address only the
12 distribution of mail processing labor costs to the subclasses of mail. I recommend that,
13 with minor programming modifications, the Degen/Van-Ty-Smith approach to
14 distributing mail processing labor costs to each mail subclass be adopted by the
15 Commission.

16 A. **The Degen/Van-Ty-Smith MODS-Based Approach Addresses the**
17 **Concerns Raised by the Commission in Docket No. R97-1.**

18 The Postal Service's approach to distributing attributable mail processing labor
19 costs to subclasses follows, for the most part, the method the Postal Service proposed
20 in Docket No. R97-1. This method was endorsed by UPS in that proceeding (subject to
21 minor modifications to address the "migration" of certain Administrative and Window
22 Service costs to the Mail Processing component of Cost Segment 3 and the distribution
23 of costs in certain "allied" pools) and was ultimately adopted by the Commission.

1 In this proceeding, the Postal Service proposes several changes to the approach
2 it recommended in Docket No. R97-1:

- 3 ♦ Costs at Non-MODS facilities have been broken into eight processing-based
4 functional cost pools rather than being based on the "Basic Function" (e.g.,
5 incoming, outgoing, transit, and other) cost pools used in Docket No. R97-1;
- 6 ♦ Costs associated with "not handling" in allied pools are distributed on a broader
7 basis than proposed in Docket No. R97-1; and
- 8 ♦ Costs in MODS "support" pools are distributed in a "piggyback" fashion based on
9 the cost pools which those pools support.

10 Each of these changes represents an improvement over the Postal Service's approach
11 in Docket No. R97-1, and they should be adopted.

12 B. The Postal Service's Proposed Distribution Method Should
13 Be Used, with Minor Modifications.

14 The improvements the Postal Service has proposed in the distribution of mail
15 processing labor costs in Cost Segment 3 represent a further evolution in the
16 development of the most appropriate methodology for distributing these costs. As the
17 Commission determined in Docket No. R97-1, improvements of this type have no
18 necessary relationship to the degree of variability of mail processing labor costs. The
19 methodology proposed by Mr. Degen and Ms. Van-Ty-Smith in this case can be easily
20 adapted to incorporate full attribution of mail processing labor costs.

1 A further adaptation is also required to conform to Commission practice with
2 respect to Cost Segment 3. The "migration" of some costs previously defined as
3 Window Service (and assigned to Cost Segment 3.2) and Administrative (and assigned
4 to Cost Segment 3.3) should be reversed to ensure treatment consistent with the
5 Commission's established practice. These are essentially the same "migration"
6 reversals that were required in Docket No. R97-1 to adapt the Postal Service's
7 approach to established Commission practice, as detailed in my supplemental
8 testimony (UPS-ST-2) in Docket No. R97-1.

9 Table 1 compares the Postal Service's proposal in this case with Dr. Neels'
10 recommended (and the Commission's established) treatment of Cost Segment 3, which
11 returns attribution of mail processing labor costs to 100 percent. UPS witness Luciani
12 combines Dr. Neels' recommended treatment as reflected in my Table 1 with the
13 recommendations of other UPS witnesses to calculate the combined impact of all of
14 these changes on Parcel Post, Priority Mail, and Express Mail in the Test Year.

TABLE 1**BY1998 Volume Variable Cost Segment 3 Costs by Class/Subclass**

Class and Subclass of Mail or Special Service	Postal Service Proposal	100% Attribution
Total First Class Mail	7,573,871	8,522,117
Priority Mail	733,035	901,232
Express Mail	127,161	185,985
Mailgrams	192	253
Total Periodicals	738,428	813,249
Total Standard (A) Mail	3,151,448	3,479,195
Standard (B) Mail		
Parcel Post	260,580	275,359
Bound Printed Matter	134,482	143,723
Special Standard	86,972	93,043
Library Mail	12,397	13,035
Total Standard (B) Mail	494,431	525,160
US Postal Service Mail	157,624	197,640
Free Mail	15,573	16,808
International Mail	294,530	339,278
Total Mail	13,286,293	14,980,919
Total Special Services	365,777	361,356
Total Volume Variable	13,652,070	15,342,275
Other	3,994,053	2,304,197
Total Accrued	17,646,123	17,646,472

Sources: Postal Service Proposal – USPS-T-11, Exhibit USPS-11A, pages 1-2.
100% Attribution – UPS-Sellick-WP-1-A, page 2. Calculation of Total Accrued does not match exactly due to rounding.

1 **CALCULATION OF IOCS OBSERVATIONS**
2 **AND TALLY DOLLARS BY COST POOL**

3 At the request of UPS witness Neels, I have calculated the number of IOCS
4 observations and the IOCS tally dollar costs in each cost pool by mail class and non-
5 mail activity code. These results are provided in Sellick-WP-2.

6 **CALCULATION OF NON-BMC OUTGOING MAIL**
7 **PROCESSING COSTS INCURRED BY DBMC-ENTRY PARCELS**

8 At the request of UPS witness Luciani, I have calculated, using the Postal
9 Service's basic approach outlined in USPS-LR-I-103, the non-BMC outgoing mail
10 processing costs incurred by DBMC entry parcels. This approach uses IOCS data to
11 determine the proportion of IOCS tally dollars by MODS pool and IOCS Basic Function
12 that can be ascribed to DBMC Parcel Post and non-DBMC Parcel Post. This
13 calculation shows that \$9.34 million in Base Year 1998 attributable mail processing
14 costs are for outgoing DBMC parcels at non-BMCs.¹ The details of the calculation are
15 provided in Sellick-WP-3.

16 **SUMMARY OF CONCLUSIONS**

17 In conclusion, I find that:

- 18 ♦ The approach to distributing attributable mail processing labor costs to
19 subclasses as proposed by Postal Service witnesses Degen and Van-Ty-Smith is

1. This approach is based on Postal Service volume variabilities for mail processing labor costs; the calculation using 100% volume variability can also be found in my workpapers.

1 an improvement over past practice and, with minor modifications, should be
2 adopted by the Commission. The Postal Service's proposal continues the
3 refinement of mail processing costing methods to more closely align the
4 distribution of mixed mail and overhead costs to mail processing operational
5 characteristics and continues to use the available data on counted mixed mail.
6 The result is an improved distribution of the costs in Cost Segment 3.

7 ♦ The Postal Service's approach can be implemented while maintaining the
8 Commission's historic practice of attributing 100 percent of mail processing labor
9 costs. The Base Year results of this approach are provided in this testimony.

10 ♦ The Postal Service's calculation of the costs avoided by DBMC-entry parcels
11 incorrectly includes \$9.34 million of costs which are actually incurred by DBMC-
12 entry parcels.